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### Strengthening Special Committees

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# STRENGTHENING SPECIAL COMMITTEES

ELIZABETH POLLMAN\*

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## INTRODUCTION

Special committees of corporate boards of directors make some of the most important decisions facing the corporation – often related to crucial transactions or litigation and sometimes involving ethical implications for the board of directors. High-quality decision-making on these issues is even more urgent in this time of economic volatility and outrage about corporate irresponsibility. Indeed, special committees may be increasingly in the spotlight as the current economic crisis will likely lead to a flood of shareholder litigation and, when credit markets thaw, a wave of strategic transactions. Although special committees consisting of only one member are not the norm, sometimes a special committee of just one person bears the responsibility of handling the entire matter.<sup>1</sup> This may be due to a board's lack of additional independent directors to put on a committee, and desire to avoid hiring a new director, or because of an oversight or failure to appreciate the value of having multiple members. It is imperative that this practice be examined because the size of the committee may significantly affect the quality of decisions that are so crucial to the corporation.

Recent scholarship has examined group decision-making in corporate governance and has made the case that group decision-making, such as corporate boards engage in, is on average superior to individual decision-making.<sup>2</sup> Indeed, there is a host of research showing that groups making decisions tend to perform better than individuals, including outperforming individuals when solving problems that require analysis and evaluation such as corporate directors engage in.<sup>3</sup> Case law has highlighted the need for more attention to the quality of decision-making by special committees of corporate boards. In light of the research on group decision-making, this need suggests that there be more focus on the number of directors participating in a special committee. Delaware courts, whose decisions are formative in the corporate

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<sup>1</sup> See *Gesoff v. IIC Indus. Inc.*, 902 A.2d 1130, 1146 (Del. Ch. 2006) (characterizing the circumstances in which special committees are comprised of only one member as “rare”).

<sup>2</sup> See Stephen M. Bainbridge, *Why A Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1 (2002); see also Robert J. Haft, *Business Decisions by the New Board: Behavioral Science and Corporate Law*, 80 MICH. L. REV. 1, 50-67 (1981); Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms and the Unintended Consequences of Independence and Accountability*, 89 GEO. L. J. 797 (2001); Note, *The Propriety of Judicial Deference to Corporate Boards of Directors*, 96 HARV. L. REV. 1894, 1896-97 (1983).

<sup>3</sup> See Bainbridge, *supra* note 2; see also Mark Seidenfeld, *Cognitive Loafing, Social Conformity, and Judicial Review of Agency Rulemaking*, 87 CORNELL L. REV. 486, 530-31 (2002) (citing Bainbridge and Gayle W. Hill, *Group Versus Individual Performance: Are N+1 Heads Better Than One?*, 91 PSYCHOL. BULL. 517, 533 (1982)).

law setting, have recognized the advantages and wisdom of having multiple members on special committees.<sup>4</sup>

This Article proposes a rule that encourages or explicitly requires special committees to consist of more than one member. Even in the absence of a formal change in corporate law on this matter, this is a structural step that boards should take to improve the quality of decisions that special committees make and to increase the perceived strength and legitimacy of their decisions. These recommendations make sense in light of the experimental data and longstanding recognition that decisions made by groups are on average superior to those made individually, as well as in light of the perceived legitimacy that decisions made by groups hold as opposed to decisions made by a single unmonitored ruler.<sup>5</sup> Critically, the existing studies on group decision-making bear only limited resemblance to the type of activities in which directors on special committees engage. The studies are generally laboratory experiments involving non-directors performing problem solving and decision-making tasks substantively unrelated to the corporate context. Yet special committees make crucial decisions for corporations and their optimal size and group processes are ripe areas for researchers to make valuable contributions. Therefore, in addition to proposing a rule for multiple-member special committees, this Article also calls out for new, more targeted empirical studies in the special committee context.

This Article proceeds in five Parts. As a starting point, Part I of this Article examines the important purpose and function that special committees serve when a corporate board is confronted with decisions that create a real or perceived conflict of interest for certain corporate directors. This background on special committees underscores the centrality of decision-making to their purpose and the importance of optimizing the decisions they make. With this foundation set out, Part II analyzes the literature on group decision-making, drawing on studies from other disciplines and legal scholarship on corporate governance. This Part of the Article seeks to add to the literature on group decision-making in the corporate governance context by exploring another

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<sup>4</sup> See *Gesoff*, 902 A.2d at 1146.

<sup>5</sup> See Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89, 170 (2004) (“While the historical and political origins of the corporate board of directors provide conflicting evidence regarding the various purposes modern commentators claim for the board, these origins suggest a critical function which modern commentators seem to have overlooked. This function is providing political legitimacy.”). For an example of informal recognition of the superiority of group decision-making, see MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* 238 (Princeton Univ. Press 1996) (“[A] single individual will do worse than a network of decisionmaking, which reduces error, similar to the way that the members of a good law firm with many high-quality people in overlapping fields can cooperate, converse, and get the job done better than a lawyer of equal quality working alone.”).

logical source – negotiation theory – that also supports using a multi-member group for decision-making and negotiation. Part III of this Article discusses recent Delaware case law reflecting a judicial preference for special committees with multiple members. These cases show that courts, in reviewing the actions of special committees, at least implicitly recognize the rationale of having committees with more than one director. In Part IV, this Article recommends that more be done to firmly establish a preference for committees with multiple members and responds to potential concerns the proposal may raise. Finally, Part V briefly concludes by highlighting key points and areas for future study.

## I. PURPOSE AND FUNCTION OF SPECIAL COMMITTEES

The context in which special committees operate shows that decision-making is one of their central activities and underscores the importance of optimizing their decisions. As a basic matter, corporate statutes provide that a corporation shall be managed by or under the direction of its board of directors, which is composed of directors elected by the shareholders and who act together to make decisions.<sup>6</sup> The board's role is commonly described as monitoring and disciplining the executive management, formulating policies, and making decisions for the corporation to maximize shareholder or firm value.<sup>7</sup> The historic rule and prevailing norm is that corporate boards consist of more than one director, although it is not generally required.<sup>8</sup>

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<sup>6</sup> See Gevurtz, *supra* note 5, at 92-94. Professor Gevurtz asserts that the origins of corporate boards provide some support for Bainbridge's argument that the rationale for having a board is the superiority of group decision-making. See *id.* at 167. Gevurtz explains that town councils, guild councils, parliaments and early trading company boards adjudicated disputes, reflecting the idea that groups are more likely to get the correct result than an individual judge. He notes that medieval parliaments had a tradition of consultation and consensus that seemingly arose from the concept of the feudal obligation of nobles to provide advice to the king. "Underlying the obligation to provide advice must be some notion of the superiority of groups over individuals in making decisions." *Id.* at 168.

<sup>7</sup> See Bainbridge, *supra* note 2, at 5, 8; see also Sanjai Bhagat & Dennis C. Carey, *Director Ownership, Corporate Performance, and Management Turnover*, 54 BUS. LAW. 885, 891 (1999) ("The primary responsibility of the corporate board of directors is to engage, monitor, and, when necessary, replace company management"); 18B Am. Jur. 2D Corporations §§ 1483-1491 (1985) (noting responsibilities of directors); Douglas G. Baird and M. Todd Henderson, *Other People's Money*, 60 STANFORD L. REV. 1309 (2008) (critically examining the conception of directors' duties).

<sup>8</sup> See Bainbridge, *supra* note 2, at 42; see also, e.g., Model Bus. Corp. Act § 8.03 cmt. 1 (2002) (Before 1969 the Model Act required three or more directors to serve on a corporate board); Edwin J. Bradley, *Toward a More Perfect Close Corporation – The Need for More and Improved Legislation*, 54 GEO. L.J. 1145, 1151 (1966). Single-person corporate boards have been allowed more recently. See Model Bus. Corp. Act § 8.03 (2002); Cal. Corp. Code § 212(a) (1990) (permitting a corporate board to have less than three board members if the

Boards typically form special committees when confronted with the special situation of making a decision or carrying out a negotiation in which certain directors have a real or perceived conflict of interest.<sup>9</sup> The board then vests authority in the special committee to resolve the sensitive matter.<sup>10</sup> Forming such special committees serves an important purpose because, depending on the type of transaction at hand, a special committee composed of disinterested directors can serve to protect the interests of the corporation's shareholders and can help board members properly carry out their fiduciary duties.

Examples of common situations in which special committees are necessary also highlight the important decision-making and negotiation functions they perform. Consider a private equity deal where a corporation's executive team would typically seek to continue to manage the corporation after a proposed merger. The team might hold an equity stake and stock options designed to encourage them to increase the value placed on the corporation in a merger. If these team members also serve on the board of directors, they may have a conflict between their own interests and the corporation's non-management shareholders who are being cashed out. For example, the interested directors might be satisfied with an offer that would keep the management team in place and consequentially they might fail to pursue the highest value for the corporation's shareholders by engaging in an active search for strategic buyers. One way to deal with the conflict posed by the interested directors, particularly where they form a majority of the board, would be to prevent them from negotiating the prospective merger and instead have a special committee serve this function for the board.<sup>11</sup> The special committee would thus step into the shoes of the board to negotiate and make a

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corporation has less than three shareholders).

<sup>9</sup> Generally state law employs the term "disinterested director" to refer to a director who does not have a conflict of interest in a particular transaction. Courts must engage in a fact specific inquiry to determine a director's disinterestedness because it varies depending on the transaction at issue. See Donald C. Clarke, *Three Concepts of the Independent Director*, 32 DEL. J. CORP. L. 73 (2007); see also Del. Code Ann. tit. 8 § 144; Model Bus. Corp. Act § 8.31(a)(3)(2005). Although the terms "disinterested director" and "independent director" can be conceptually distinguished from each other, this Article follows common practice and uses the terms interchangeably. See Clarke at 74-76, 104-05 (explaining distinctions between the various manifestations of the term "independent director," including "disinterested director"); *Gesoff*, 902 A.2d at 1145-46 ("Members of a special committee negotiating a parent-subsubsidiary merger must, of course, be independent and willing to perform their job. This is the *sine qua non* of the entire negotiation process.").

<sup>10</sup> See, e.g., Del. Code Ann. tit. 8, § 141 (e) (2009) (recognizing the board's authority to delegate authority to a committee of the board).

<sup>11</sup> The special committee should be formed at an appropriately early stage to handle the matter at issue. Once formed, the special committee must gather information and deliberate without the interested directors and seek sufficient, independent legal and financial advice. See, e.g., *In re Netsmart Tech., Inc. S'holders Litig.*, 924 A.2d 171, 193 (Del. Ch. 2007).

decision regarding the proposed transaction. This process should keep the interested directors effectively quarantined with respect to the transaction.

Boards also often use special committees to handle conflicts of interest posed by transactions involving a controlling shareholder or when selling control of the corporation. Courts apply varying levels of scrutiny to the board's use of a special committee depending on the factual scenario and type of transaction at issue. For example, where the board decides to sell the corporation for cash, the board members typically assume a fiduciary duty to undertake reasonable efforts to secure the highest price realistically achievable.<sup>12</sup> This duty requires the board to act reasonably by engaging in a logically sound process to get the best deal attainable.<sup>13</sup> Unlike the bare rationality standard applicable to common, garden-variety business decisions, the standard applicable where the heightened duty is triggered – often called a *Revlon* duty – involves a judicial examination of the reasonableness of the board's decision-making process.<sup>14</sup> “[T]his reasonableness review is more searching than rationality review, and there is less tolerance for slack by the directors. Although the directors have a choice of means, they do not comply with their *Revlon* duties unless they undertake reasonable steps to get the best deal.”<sup>15</sup> An important way to set the stage for taking those reasonable steps is often for the board to form a special committee to handle the transaction. The disinterestedness of the directors on the special committee demonstrates the board's intention for the special committee to engage in arm's length negotiation to get the best deal.

Another example of a situation in which the special committee framework is often used is a freezeout merger or going private transaction such as in the well-known Delaware case, *Weinberger v. U.O.P. Inc.*, 457 A.2d 701 (Del. 1983). In *Weinberger*, the Delaware Supreme Court subjected the transaction to a level of scrutiny known as “entire fairness,” which is higher than the business judgment standard. This includes a judicial review for fair price and fair dealing, which encompasses a review of the disclosures

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<sup>12</sup> See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 184 n.16 (Del. 1986) (“The directors’ role remains an active one, changed only in the respect that they are charged with the duty of selling the company at the highest price attainable for the stockholders’ benefit.”); *Paramount Comm’ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 44 (Del. 1994) (“In the sale of control context, the directors must focus on one primary objective – to secure the transaction offering the best value reasonably available for the stockholders – and they must exercise their fiduciary duties to further that end.”).

<sup>13</sup> See, e.g., *QVC*, 637 A.2d at 45 (“[A] court applying enhanced judicial scrutiny should be deciding whether the directors made a reasonable decision, not a perfect decision. If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board’s determination.”).

<sup>14</sup> See *QVC*, 637 A.2d at 45.

<sup>15</sup> *In re Netsmart*, 924 A.2d at 192.

made as well as procedural issues such as timing, negotiation and structure.<sup>16</sup> The court found the transaction did not meet the entire fairness standard, but suggested that it may have found differently had the board used a committee of independent directors acting at arm's length.<sup>17</sup> The idea was that a special committee would allow the board to replicate the type of arm's length negotiation that would occur if a disinterested board was negotiating a buyout. Since *Weinberger*, in situations where a majority shareholder seeks to acquire the remaining shares of the corporation through a merger, a board will typically form a committee of the independent directors to consider and negotiate the merger. Under Delaware law, in freezeout and other control transactions, if the board forms a special committee that is properly composed and follows proper procedure then the burden of proof may shift to the complaining shareholder.<sup>18</sup> This can be a significant advantage for directors in litigation.

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<sup>16</sup> See *Weinberger v. U.O.P. Inc.*, 457 A.2d 701, 710-11 (Del. 1983). Other states have followed various aspects of the Delaware approach, whereas some courts have disagreed with Delaware and retained a business purpose test. See, e.g., *Stringer v. Car Data Sys., Inc.*, 841 P.2d 1183 (Or. 1992) (following *Weinberger* by using a variety of financial valuations in determining fair price and noting that appraisal may be the exclusive remedy if there is unlawful conduct such as self-dealing, fraud, deliberate waste or misrepresentation); *Coggins v. New England Patriots Football Club, Inc.*, 492 N.E.2d 1112 (Mass. 1986) (applying a business purpose test of fairness in freezeout mergers before looking at fairness); *Alpert v. 28 Williams Street Corp.*, 63 N.Y. 2d 557 (N.Y. 1984) (requiring that the transaction have a valid business purpose in addition to subjecting the transaction to an entire fairness review).

<sup>17</sup> Specifically, the court stated:

Although perfection is not possible, or expected, the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm's length. Since fairness in this context can be equated to conduct by a theoretical, wholly independent, board of directors acting upon the matter before them, it is unfortunate that this course apparently was neither considered nor pursued. Particularly in a parent-subsidary context, a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's length is strong evidence that the transaction meets the test of fairness.

*Weinberger*, 457 A.2d at 709 n.7 (internal citations omitted).

<sup>18</sup> See *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110 (Del. 1994) (refining the rule established in *Weinberger* by holding that approval by an acquirer special committee did not obviate the entire fairness review, but did shift the burden of proof from the acquirer to the challenging shareholders); see also *In re Pure Resources, Inc. S'holders Litig.*, 808 A.2d 421 (Del. Ch. 2002) (holding the entire fairness standard applies to merger transactions, not tender offers). The special committee members must be independent, informed and active participants in the committee's deliberations, as well as simulate an arm's length negotiation. See *Kahn v. Tremont Corp.*, 694 A.2d 422 (Del. 1997). State law varies on this burden-shifting point and on freezeout and going private transactions generally. See *supra*, note 16.



Finally, special committees are commonly formed in response to a shareholder derivative lawsuit. Known as a special litigation committee or “SLC,” this particular type of special committee has its roots in the 1970’s when a number of U.S. corporations and their representatives made questionable payments.<sup>19</sup> With a crowded docket of these cases, the Securities and Exchange Commission instituted a voluntary compliance program to handle them efficiently. Under the program, corporations that investigated their own matters, made disclosures, and developed procedures for handling possible illegal payments, would receive a less severe punishment than the Commission might have otherwise imposed. Corporations quickly developed the mechanism of using a committee of outside directors, assisted by independent legal counsel, to take advantage of the voluntary compliance program. Shortly thereafter, corporations applied the same technique in response to shareholder derivative lawsuits.<sup>20</sup> Typically, the board would assign the committee of disinterested and often recently appointed directors<sup>21</sup> the task of investigating the charges and preparing a report recommending whether the lawsuit should proceed. Often an outside advisor, such as special counsel that did not otherwise represent the corporation, would assist the SLC. The use of such SLCs gained popularity in the 1980’s, particularly with the takeover boom of that era. In the vast majority of cases, SLCs recommended dismissing the lawsuits. Courts have responded to SLCs with varying levels of scrutiny.<sup>22</sup>

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<sup>19</sup> Kenneth B. Davis, Jr., *Structural Bias, Special Litigation Committees, and the Vagaries of Director Independence*, 90 IOWA L. REV. 1305, n.181 (2005); *see also* Arthur Matthews, *Internal Corporate Investigations*, 45 OHIO ST. L.J. 655, 666-70 (1984) (describing the development of SLCs).

<sup>20</sup> *See* Gall v. Exxon Corp., 418 F. Supp. 508 (S.D.N.Y. 1976) (an early case involving a SLC in which the court dismissed the derivative suit after the board formed a SLC which investigated the lawsuit and concluded that it was not in the best interests of the corporation or its shareholders to maintain the lawsuit).

<sup>21</sup> Typically, SLCs would consist of two or three directors. Under the Model Business Corporation Act (MBCA), an SLC of *at least two* independent directors may seek dismissal of derivative litigation after a shareholder has made the obligatory pre-lawsuit demand. MBCA § 7.44(a). Delaware law does not have a requirement that an SLC be constituted of more than one director, however in *Lewis v. Fuqua*, 502 A.2d 962, 967 (Del. Ch. 1985), the court noted that “[i]f a single member committee is to be used, the member should, like Caesar’s wife, be above reproach.” In that case, the court refused to follow the SLC’s recommendation to dismiss the lawsuit pending against Fuqua Industries’ senior management because the sole director on the SLC had ties to Fuqua Industries — a \$10 million dollar gift the company gave to Duke’s Business School when the director was president of Duke University. *Id.*

<sup>22</sup> *See, e.g.,* Auerbach v. Bennett, 393 N.E.2d 994 (N.Y. 1979) (holding a SLC’s recommendation to dismiss litigation was entitled to judicial deference under the business judgment doctrine unless the plaintiff showed the committee’s members were interested or had not acted on an informed basis); *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981) (establishing a two-part inquiry applicable in demand-excused cases, involving procedural

The foregoing examples illustrate the context and critical nature of the decision-making and negotiation tasks that corporate boards tend to assign to special committees. Given the importance of these tasks, improving the committees' decisions may directly translate into value for the corporation in terms of better deals and fewer costly lawsuits.<sup>23</sup> Better deals may result because both group decision-making research and negotiation theory show that decisions made by groups tend on average to be superior to those made by individuals, and teams have advantages in negotiations.<sup>24</sup> Fewer costly lawsuits are another likely result because some courts have already signaled their preference for multiple-member committees.<sup>25</sup> Single-member special committees could become a magnet for lawsuits and courts could subject their decisions to a higher level of scrutiny.

## II. STUDIES AND LITERATURE ON GROUP DECISION-MAKING AND APPLICATION TO SPECIAL COMMITTEES

This Article continues the work of other scholars who have drawn on studies in law and other disciplines to support arguments based on the premise that groups generally outperform individuals. Group decision-making has long been an area of study in the law and in certain other fields law such as behavioral economics and psychology.<sup>26</sup> For instance, scholars studying the merits of the jury system have used the data on group decision-making for some time.<sup>27</sup> Notably, the judiciary has taken express notice of this empirical and scholarly work, particularly in the context of reviewing challenges to

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and substantive review, to determine whether a SLC's recommendation to dismiss would be respected); *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984) (limiting *Zapata* by making demand a requirement in many cases).

<sup>23</sup> In addition to potentially negative publicity from shareholder lawsuits and the distraction and stress they bring to corporate directors, lawsuit costs arise in the form of legal fees, settlement costs, and perhaps higher costs for director and officer liability insurance. See Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 Stan. L. Rev. 1055, 1099 (2006). It is generally the corporation itself that bears the brunt of these costs because outside directors rarely pay "out-of-pocket" for liability in shareholder suits. See *id.* at 1059-60.

<sup>24</sup> See *infra* Part II.

<sup>25</sup> See *infra* Part III.

<sup>26</sup> See *infra*, Part II.a. Also outside legal scholarship, but widely influential, is Kenneth Arrow's work on group decision-making. See KENNETH J. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES (John Wiley 2d ed., 1963); see also MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOVERNMENT AND THE THEORY OF GROUPS (Harvard University Press 1965); NORMAN SCHOFIELD, COLLECTIVE DECISIONMAKING: SOCIAL CHOICE AND POLITICAL ECONOMY (Springer 1996).

<sup>27</sup> See *Ballew v. Georgia*, 435 U.S. 223, 232 n.10 (1978) (listing a survey of scholarly work on jury size); see also Michael J. Saks, *Book Review: Blaming the Jury*, 75 GEO. L.J. 693, 706-07 (1986) (reviewing Valerie P. Hans & Neil Widmar's JUDGING THE JURY (1986)).

reduced jury size.<sup>28</sup> The Supreme Court has even applied specific data from empirical studies on group decision-making in the context of challenges to jury size, with a sharp focus on the consistency and reliability of groups with fewer than six members.<sup>29</sup>

More recently, legal scholarship has successfully drawn upon the studies and literature on group decision-making in the context of corporate governance. Most notably in that area, scholars have used experimental data showing the superiority of group decision-making to explain why a board of directors, as opposed to an individual decision-maker, sits atop the corporate hierarchy.<sup>30</sup>

In addition to the corporate governance literature drawing upon the group decision-making studies, negotiation scholars have long argued that teams have advantages in negotiations. This insight could apply in the corporate governance context because decisions made by groups such as special committees inherently involve activities that are analogous to negotiation processes, and special committees also commonly engage in external formal negotiation.

This part summarizes and explains why such studies and literature provide insights into possible improvements for the structure of special committees. These studies and literature on group decision-making then provide the basis for recommendations concerning special committees, set forth in Part IV.

#### A. *Multidisciplinary Studies on Group Decision-Making*

As a general matter, studies on group decision-making have repeatedly shown the superiority of group performance over the average individual performance.<sup>31</sup>

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<sup>28</sup> See *Ballew*, 435 U.S. at 224-28 (holding that “the five-member jury d[id] not satisfy the jury trial guarantee of the Sixth Amendment, as applied to the States through the Fourteenth”). In *Ballew*, the Supreme Court applied the principles enunciated in *Williams v. Florida*, 399 U.S. 78 (1970), which upheld the use of a six-person jury in a state criminal trial, but examined the empirical data available post-*Williams* and concluded that such data raised “significant doubts about the consistency and reliability of the decisions of smaller juries.” See *Ballew*, 435 U.S. at 235. The *Ballew* Court noted specific empirical studies showing several key points about how size relates to group performance: (1) “[g]enerally, a positive correlation exists between group size and the quality of both group performance and group productivity”; (2) “[t]he smaller the group, the less likely are members to make critical contributions necessary for the solution of a given problem”; (3) “the smaller the group, the less likely it is to overcome the biases of its members to obtain an accurate result.” *Id.* at 232-33.

<sup>29</sup> See *id.* at 235, 239.

<sup>30</sup> See Bainbridge, *supra* note 2, at 54-55.

<sup>31</sup> Although this is largely accepted as a general matter, some qualifications to this statement are necessary because of the wide variety of tasks and ways of measuring performance. See

### 1. Summary of Key Studies

Research examining individual versus group performance dates back over a hundred years.<sup>32</sup> The tasks and structures of the early studies bear little resemblance to the type of decision-making that directors engage in, but the research formed the basis of later studies that have involved increasingly comparable tasks and structures. The very first social psychology experiment dates to the late nineteenth century and its focus was on the fundamental question of whether the presence of another person improves or hinders individual performance on a task.<sup>33</sup> Specifically, the experiment tested whether an individual competing against another person would complete a simple laboratory task faster than when completing the task alone. The study showed that people usually worked faster when competing than when doing the task alone. Similar experiments followed in the early 1900's.<sup>34</sup>

One researcher then devised a laboratory task that removed the competitive element from the experiment and tested whether individuals carried out cognitive tasks better in groups or alone.<sup>35</sup> The results of this study quickly led to much more experimentation and refinement of explanatory theories about group performance.<sup>36</sup> Psychologist Marjorie E. Shaw's study from the 1930's was one of the most notable of these early experiments on group performance.<sup>37</sup> In Shaw's study, students solved

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Rupert Brown, *GROUP PROCESSES* 221 (2d ed. 2001); ANTONY S. R. MANSTEAD & MILES HEWSTONE, *THE BLACKWELL ENCYCLOPEDIA OF SOCIAL PSYCHOLOGY* 272-75 (1996). For example, a group may outperform an individual, but the group may perform less well than would be predicted by taking the sum of its individual members' potential performances. This is easily imaginable: a group pulling on a rope might pull more weight than an individual, but the total weight pulled by the group might be less than each member's potential due to coordination losses or social loafing. Similarly, groups may outperform the average individual at solving problems in a study, but once the data is "statisticized" it could show that this is due to the groups simply benefiting from increasing their chances of having one member amongst them who can solve the problems. In other words, groups may outperform individuals but the differences may in some instances be due to the benefits inherent in having greater numbers.

<sup>32</sup> See Brown, *supra* note 31, at 169.

<sup>33</sup> See *id.* (citing N. Triplett, *The dynamogenic factors in pacemaking and competition*, 9 AM. J. PSYCHOL. 507-33 (1898) (involving the task of winding fishing reels)).

<sup>34</sup> See *id.* (citing Allport, 1924; Dashiell, 1930; Moede, 1920-1). "Coactors or a passive audience tend to improve performance of a well-learned or easy task, but impede performance of a poorly learned or difficult task. In general, however, groups are interactive entities, and the question becomes one of whether the task is better accomplished by interaction in a group, or simply by individuals working alone." See Manstead, *supra* note 31, at 271-72.

<sup>35</sup> See Brown, *supra* note 31, at 169-70 (citing F.H. ALLPORT, *SOCIAL PSYCHOLOGY* (Houghton Mifflin 1924)).

<sup>36</sup> See *id.*

<sup>37</sup> See Marjorie E. Shaw, *A Comparison of Individuals and Small Groups in the Rational Solution of Complex Problems*, 44 AM. J. PSYCHOL. 491, 492-504 (1932); see also Bainbridge, *supra* note 2, at 12-13 (discussing study by Shaw); Brown, *supra* note 31, at 174-

various reasoning problems. Half of the students worked as members of random four-person groups whereas the other half of the students worked alone. A higher proportion of the groups were able to solve the problems than the individuals.

Psychologist D.I. Marquart replicated Shaw's study in 1955 using similar problems.<sup>38</sup> Like Shaw, Marquart again showed that groups were more likely to solve the problems. However, Marquart used the data to make different comparisons between the individuals and groups than Shaw had earlier. Marquart randomly combined the individuals into "nominal" or hypothetical groups and analyzed how many of these "statisticized" groups would have solved the problems – i.e., how many of these hypothetical groups contained an individual who had individually solved the problems. She found no difference between the performances of the hypothetical groups and the real interacting groups.<sup>39</sup> This suggested that groups outperformed individuals, but that groups tended to perform better simply because their numbers increased their chances of having a member who could solve the problems.

In the 1980's, Professor Frederick C. Miner, Jr., a professor of management, conducted another notable experiment that showed that groups outperformed the average individual subject.<sup>40</sup> However, the study also revealed that groups tended to be less accurate than the best decision-maker within each group. Miner's study used 69 self-selected groups of four undergraduate business students who shared the single goal of correctly solving the "winter survival exercise." The exercise required study participants to decide questions faced by hypothetical airplane crash survivors in a remote location, such as whether to stay or leave the crash site, and how to rank the utility of 15 survival aids. This study perhaps came closer to replicating corporate governance by using business students who shared a single goal when performing as a group. Directors, at least theoretically, have a common goal just as the business students in the Miner study shared a clearly defined goal of best resolving the exercise. Other parallels between the study participants and board members included that the study participants knew each other before forming groups for the study, presumably had backgrounds in business and the exercise allowed the participants to pool their knowledge and evaluate their options in light of their common goal as a board or committee will do.

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75 (same).

<sup>38</sup> See Brown, *supra* note 31, at 175; Manstead, *supra* note 31, at 274-75.

<sup>39</sup> See Brown, *supra* note 31, at 175.

<sup>40</sup> See Frederick C. Miner, Jr., *Group Versus Individual Decisionmaking: An Investigation of Performance Measures, Decision Strategies, and Process Losses/Gains*, 33 ORG. BEHAV. & HUM. PERFORMANCE, 112 (1984); see also Bainbridge, *supra* note 2, at 17-18.

As for the best decision-maker aspect of the Miner study findings, it may be of little practical use because in the real world groups have difficulty identifying *ex ante* the best decision-maker in the group.<sup>41</sup> In other words, although the best individual decision-maker might outperform the average group, it is likely not possible to identify the best individual before the decision is made. This difficulty may stem from overconfidence bias, information asymmetries, collective action problems, status differentials, social norms and bounded rationality problems.<sup>42</sup> Indeed, Miner's study showed no statistical difference with respect to the ability of groups to pick its best decision-maker *ex ante* versus the random chance of such identification.<sup>43</sup> Simply put, groups did no better at picking their best decision-maker before the fact, than would a disinterested party choosing randomly by flipping a coin. Given the other findings of the study, this suggests that it is desirable to have groups make decisions because they perform better than the average individual does. In addition, by their sheer numbers, groups increase their chances of having a top performer amongst their members from whom they all can benefit.

This does not appear to be the only reason groups outperform individuals. Researcher William L. Faust used a similar technique as Marquart to analyze the performances of real and statisticized groups who had a series of spatial and verbal problems to solve. He found that there was little difference in performance between the real and statisticized groups on the spatial problems, but that the real groups did better on the verbal problems.<sup>44</sup> Similarly, psychologists Marvin E. Shaw and N. Ashton found that groups performed as predicted based on individual performance data on simple crossword puzzles, but on puzzles that are more difficult, they did better than expected.<sup>45</sup> These studies, as well as others, provide evidence that groups can

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<sup>41</sup> See Bainbridge, *supra* note 2, at 26-27.

<sup>42</sup> See Bainbridge, *supra* note 2, at 26. The term "bounded rationality," originated by U.S. Nobel laureate economist Herbert Simon, refers to the concept that all decision-makers make their decisions under the constraints of limited information, limited cognitive ability to process and evaluate the available information, and limited time to make the decision. This concept stands in contrast with the assumption in some models of human behavior in the social sciences that assumes human rationality. Given the constraints on rational choice, decision-makers effectively aim to "satisfice" rather than determine the optimal solution, meaning they will consider alternatives only until one is identified that is satisfactory even though it may not be the best available alternative. See HERBERT A. SIMON, *MODELS OF MAN: SOCIAL AND RATIONAL – MATHEMATICAL ESSAYS ON RATIONAL HUMAN BEHAVIOR IN SOCIETY* SETTING 204-05 (John Wiley ed., 1957); JAMES G. MARCH & HERBERT A. SIMON, *ORGANIZATIONS*, 140-41 (John Wiley & Sons, Inc. 1958).

<sup>43</sup> See Miner, *supra* note 40, at 118-2021; see also Bainbridge, *supra* note 2, at 26.

<sup>44</sup> See Brown, *supra* note 31, at 186 (citing W.L. Faust, *Group versus individual problem solving*, 59 J. ABNORMAL & SOC. PSYCHOL. 68-72 (1959)).

<sup>45</sup> See *id.* (citing Marvin E. Shaw & N. Ashton, *Do assembly bonus effects occur on*

exceed the sum of their individual potential when faced with more challenging cognitive tasks.<sup>46</sup> Researchers have observed other factors that lead to group process gains, such as the importance of the group itself to its members and prevailing values or cultures that favor collectivism rather than individualism.<sup>47</sup> In sum, this shows that not only do groups generally outperform individuals; they also sometimes outperform their collective potential through group processes. Finally, in addition to the studies discussed above, other studies have generated results that continue to illustrate the superiority of group decision-making.<sup>48</sup>

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*disjunctive tasks? A test of Steiner's theory*, 8 BULL. PSYCHONOMIC SOC'Y 469-71 (1976)).

<sup>46</sup> See *id.* at 185-86, 221.

<sup>47</sup> See *id.* at 221.

<sup>48</sup> See Bainbridge, *supra* note 2, at 18 (citing Starr Roxanne Hiltz et al., *Experiments in Group Decision Making: Communication Process and Outcome in Face-to-Face Versus Computerized Conferences*, 13 HUM. COMM. RES. 225, 231 (1986)); see also Larry K. Michaelsen et al., *A Realistic Test of Individual Versus Group Consensus Decision Making*, 74 J. APPLIED PSYCHOL. 834 (1989) (summarizing a study showing that 215 of 222 groups in the study performed better than their best member); see also Bainbridge, *supra* note 2, at 24-25. Notably, one of the study architects, Larry Michaelsen, has roots in team-based work in both academic and corporate settings. Michaelsen is known as the originator of the idea of team-based learning in the 1970's. See LARRY K. MICHAELSEN, *TEAM-BASED LEARNING: A TRANSFORMATIVE USE OF SMALL GROUPS* vii-viii (Greenwood Publishing Group, Inc. 2002).

More recently, economists Alan S. Blinder and John Morgan conducted two laboratory experiments that again resulted in better performance by groups than individuals. In the first, individuals and groups of five undergraduates played a game that involved a straightforward statistical problem-solving game. See Alan S. Blinder & John Morgan, *Are Two Heads Better Than One?: An Experimental Analysis of Group vs. Individual Decisionmaking* (Nat'l Bureau of Econ. Research, Working Paper No. 7909, 2000), available at <http://www.nber.org/papers/w7909> (describing the problem and the experiment results); see also Bainbridge, *supra* note 2, at 13-14. The study allowed group members to communicate freely with each other. On average, the groups scored higher than individuals, with the difference being statistically significant. In a second study, Blinder and Morgan required the participants to use more expertise and arguably more critical judgment, suggesting that the study results may carry more weight in the corporate governance context than the first study. In the second study, students who had taken at least one course in macro economics were asked to make economic policy decisions posed by a computer model. The study's authors found that the performance of the best member of the group did not predict group performance and the groups performed better on average than individuals. These studies support the view that groups perform better due to synergy or some other effect rather than simply because groups benefit from their best member.

One additional point is worth noting. For many years, researchers have questioned whether groups perform decision-making or problem solving tasks more slowly than individuals. Notably in the Blinder and Morgan study, there was no significant difference in the speed with which individuals and groups performed. See Blinder, *supra*, at 13; Bainbridge, *supra* note 2, at 14.

## 2. Theories on Group Decision-Making Strengths

Scholars in various fields have posited several possible reasons for superior group decision-making performance, including groups' ability to correct errors, the averaging function groups may benefit from, groups' ability to pool memories and skills, and the interaction groups engage in which may foster useful examination of judgments.<sup>49</sup> To elaborate a bit on these theories, the first, error correction, refers to the notion that groups seem to be very effective at rejecting incorrect ideas that individuals might not notice as incorrect.<sup>50</sup> Groups usually find the correct solution to a problem that has a demonstrably correct solution, whereas individuals vary more widely in their ability to do so.<sup>51</sup>

Second, groups appear to provide an averaging function of the group members' choices, which reduces nonsystematic errors in decisions. In situations where a problem has a solution that group members cannot show is correct given the information available, group decisions tend to be about as accurate as the statistical mean of the group members' decisions.<sup>52</sup> Researchers have posited that the group averaging function may decrease inaccuracies that individual members introduce by being unaware of or ignoring relevant information, as well as alleviate the dilution effect that stems from irrational reliance on irrelevant information.<sup>53</sup>

Third, groups appear to benefit from pooling their members' decision-making skills, knowledge and memories.<sup>54</sup> The idea is that if a group effectively marshals the resources of its members and allocates each subtask to the best member for that task, the group may benefit from a level of knowledge that approaches the sum of its individual members' knowledge. The group may perform as well or better than any of its individual members could because the member best situated to handle each subtask would perform it.<sup>55</sup>

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<sup>49</sup> See Seidenfeld, *supra* note 3, at 530-34.

<sup>50</sup> See Marjorie E. Shaw, *A Comparison of Individuals and Small Groups in the Rational Solution of Complex Problems*, 44 AM. J. PSYCHOL. 491, 502 (1932); see also Gayle W. Hill, *Group Versus Individual Performance: Are N+1 Heads Better Than One?*, 91 PSYCHOL. BULL. 517, 533 (1982).

<sup>51</sup> See Seidenfeld, *supra* note 3, at 530 & n.237 (citing Daniel Gigone & Reid Hastie, *Proper Analysis of the Accuracy of Group Judgments*, 121 PSYCHOL. BULL. 149, 149 (1997); Patrick R. Laughlin & Alan L. Ellis, *Demonstrability and Social Combination Processes on Mathematical Intellectual Tasks*, 22 J. EXPERIMENTAL SOC. PSYCHOL. 177, 184 (1986)).

<sup>52</sup> See Seidenfeld, *supra* note 3, at 531 & n.239 (citing Gigone & Hastie, *supra* note 51).

<sup>53</sup> See *id.* at 531 & nn.240-42. The dilution effect is the tendency of people to underutilize diagnostic evidence in making predictions or decisions when that evidence is accompanied by irrelevant information.

<sup>54</sup> See *id.* at 532 & nn.243-46 (citing Bainbridge, *supra* note 2, at 21; Hill, *supra* note 50, at 522 and 525; and Gigone & Hastie, *supra* note 51, at 160).

<sup>55</sup> See Seidenfeld, *supra* note 3, at 532-33 (discussing the pooling theory although noting its



Finally, scholars have posited that discussion between group members fosters critical evaluation and generates synergy that improves decision-making.<sup>56</sup> Regardless of which of these theorized reasons holds the most explanatory power, they illustrate the diverse strengths of groups in the decision-making context.

*B. Corporate Governance Literature and Negotiation Theory on Group Decision-Making*

Legal scholars have examined the question of whether groups generate better results than individuals do, often applying principles from other disciplines such as psychology and economics. Particularly applicable here is corporate law scholarship and negotiation theory.

Corporate law scholars have applied such work to the context of boards of directors. Perhaps the most extensive work done to date is an article by Professor Bainbridge that provides an extensive survey of experimental data suggesting that groups often make better decisions than individuals do, and observes that the conditions under which groups have outperformed individuals in laboratory settings have important similarities to the decision-making of boards of directors.<sup>57</sup> Bainbridge applied these findings to argue that the very existence of boards of directors at the top of the corporate hierarchy follows logically from the evidence on the superiority of group decision-making.<sup>58</sup> Regardless of whether one agrees with his conclusion, his work expertly synthesizes the data from multiple studies and persuasively analyzes the context of the studies and their applicability to the board decision-making scenario.<sup>59</sup>

Also applicable is the work of negotiation theorists. When special committees contain more than one member they are model small groups – implicitly negotiating the process of decision-making and often explicitly negotiating key terms of transactions or settlements with others outside the group. These aspects of special committees make the group decision-making and negotiation theory literature particularly apt.

To elaborate, where the power to decide is shared among two or more participants, as is the case on corporate boards and in special committees with multiple members, decisions must effectively be negotiated.<sup>60</sup> This is not to

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imperfections); see also Bainbridge, *supra* note 2, at 22-24 (discussing studies reporting groups outperforming individual decision-makers).

<sup>56</sup> See Seidenfeld, *supra* note 3, at 534.

<sup>57</sup> See Bainbridge, *supra* note 2.

<sup>58</sup> See *id.*

<sup>59</sup> The influence of his work can be seen in other literature such as Professor Seidenfeld's article on cognitive biases and group decision-making in the context of agency rulemaking. See Seidenfeld, *supra* note 3.

<sup>60</sup> See Carrie J. Menkel-Meadow, *When Winning Isn't Everything: The Lawyer As Problem*

say that all group decisions are made through explicit negotiation, but rather that they naturally involve negotiation-style processes. For example, it is only in rare circumstances that all members of a group agree without discussion on the way to achieve a complex goal.<sup>61</sup> Professor Roger Fisher, widely viewed as one of the founders of negotiation theory, has described negotiation as “back-and-forth communication designed to reach an agreement.”<sup>62</sup> This broad description fits the kind of deliberations in which boards and committees engage when evaluating options and making decisions. Further highlighting the parallels between decision-making and negotiation, one psychology scholar has characterized decision-making, without specification as to whether done individually or in a group, as “a kind of conflict resolution in which contradictory goals have to be negotiated and reconciled.”<sup>63</sup> Moreover, applying negotiation theory is apt because special committees often handle formal external negotiations, such as negotiating an acquisition proposal or resolving shareholder litigation. These situations require that the special committee negotiate with another party, and therefore the question, whether having more than one member is advantageous to the committee, is pertinent.

Perhaps most notable for purposes of this Article is the observation that negotiations between groups, or where at least one side has more than one participant, often produce agreements that are more valuable.<sup>64</sup> Negotiation

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*Solver*, 28 HOFSTRA L. REV. 905, 913-14 (2000) (“Those who study thinking processes—cognitive and social psychologists and decision scientists—have produced empirical studies and helpful information about how individuals and groups make decisions, judgment, and draw conclusions—all of which affect the ability to negotiate with others and solve problems.”); see also Gregory E. Kersten, *Support for Group Decisions and Negotiations*, [http://www.iiasa.ac.at/Research/DAS/interneg/research/misc/intro\\_gdn.html](http://www.iiasa.ac.at/Research/DAS/interneg/research/misc/intro_gdn.html) (“If the power to decide is shared among two or more participants, then decisions need to be *negotiated*.”) (emphasis in original).

<sup>61</sup> One scholar has made a similar point about group decision-making in the context of criticizing direct democratic processes. See Sherman J. Clark, *A Populist Critique of Direct Democracy*, 112 HARV. L. REV. 434, 463 (1998) (“Group decisionmaking, even when reduced to a process of preference aggregation, is not merely an exercise in communicating and adding together individual desires. Rather, it is a process of balancing, blending, and reconciling sometimes conflicting desires into some sort of minimally coherent whole.”).

<sup>62</sup> ROGER FISHER, WILLIAM URY & BRUCE PATTON, *GETTING TO YES: NEGOTIATING AGREEMENT WITHOUT GIVING IN*, at xvii (2d ed. 1991).

<sup>63</sup> See Ola Svenson, *Decision Making and the Search for Fundamental Psychological Regularities: What Can Be Learned From a Process Perspective?*, 65 ORG. BEHAV. & HUM. DECISION PROCESSES 252 (1996). Similarly, multi-group negotiations such as negotiations between nations, labor and management confrontations, and parliament, have been termed “intergroup decisionmaking.” See Manstead, *supra* note 31, at 267.

<sup>64</sup> See Robert S. Adler and Elliot M. Silverstein, *When David Meets Goliath: Dealing with Power Differentials*, 5 HARV. NEGOT. L. REV. 1, 106 (2000) (noting that research suggests group or teams produce better agreements not because of power differentials but rather because team members can find different ways of expanding the total value of the deal); see

scholars suggest this is due to having additional sources of advice, emotional support, objectivity, more numerous and fresh ideas to expand value, and an extra set of eyes and ears in the negotiation process.<sup>65</sup>

Negotiation scholars have found that being outnumbered or alone is disadvantageous in most negotiation situations because greater numbers help in the various activities that take place in seeking an agreement or decision, such as talking, listening and formulating questions.<sup>66</sup> Scholars claim team advantages include a better ability to outbargain solos, find creative solutions to problems, discover more information about the parties' needs and interests, and even increase the total amount of resources available. Notably, scholars observe that the benefit of having a team rather than going it alone is not based on a power differential or intimidation factor stemming from a difference in numbers. Instead, advantages flow from having more than one person to aid in the information gathering, explanation and evaluation processes.<sup>67</sup> The logical connection between the observation that groups often produce more valuable agreements and that it is beneficial to have more than one person on a negotiation team is that having more than one person on a special committee will also lead to better decisions and outcomes.

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also Anne G. Perkins, *Negotiations: Are Two Heads Better Than One?*, 71 HARV. BUS. REV. 13 (1993) (discussing research indicating that two-on-one negotiations often produce more valuable agreements for both sides than one-on-one negotiations because teams are better at discerning interests and increasing the overall value of the resources or deal being negotiated).

<sup>65</sup> See Carrie Menkel-Meadow, *Toward Another View of Legal Negotiation: The Structure of Problem Solving*, 31 UCLA L. REV. 754, 821-22 & n.263 (1984) (citing ROGER FISHER & WILLIAM URY, *GETTING TO YES: NEGOTIATING AGREEMENT WITHOUT GIVING IN* 94-98 (1981)); see also *id.* at n.255 ("[T]he adage 'two heads are better than one' captures the sense of synergy accompanying negotiation session which is more problem-solving than adversarial."). Interestingly, empirical research has also shown that when both parties approach negotiation with the objective of working in a collaborative rather than adversarial fashion, they share more information about their needs, which facilitates the search for solutions. See *id.* at 821 ("[P]arties may begin with a greater number of possible solutions simply because two heads are better than one."); see also Adler & Silverstein, *supra* note 64, at 106.

<sup>66</sup> See John L. Graham & Roy A. Herberger, Jr., *Negotiators Abroad: Don't Shoot From the Hip*, 61 HARV. BUS. REV. 160, 162 (1983) (advising that in international negotiations, business people bargain in teams because "[b]eing outnumbered or, worse, being alone is a terrible disadvantage in most negotiating situations. Several activities go on at once - talking, listening, thinking up arguments and making explanations, and formulating questions, as well as seeking an agreement. Greater numbers help in obvious ways with these.").

<sup>67</sup> Also notable is the concept that teams benefited by improving the overall quality of the negotiations through efforts to expand the pie and find creative solutions. See Perkins, *supra* note 64, at 14 (discussing a study by Thompson, Brodt, and Peterson finding that teams outperformed solo negotiators to gain on average 60% of the resources being negotiated, but that the solos were not worse off because they received as much as they would have received if they had been negotiating against another solo instead of a team).

Group decision-making research done to date has not focused on the specific application to special committees that this Article proposes. The wealth of research and theory on group decision-making and team negotiation is nevertheless applicable. Delaware courts have suggested this in recent cases – underscoring the need for additional study and closer analysis of this application as well as the potential for new rules or fine-tuning the standards concerning the size of special committees.

### III. RECENT DELAWARE CASE LAW REFLECTING A JUDICIAL PREFERENCE FOR SPECIAL COMMITTEES WITH MULTIPLE MEMBERS

According to a growing volume of scholarly work, group decision-making is generally superior to that done by individuals. Noting this principle, recent Delaware decisions reviewing special committees' decisions show the court's preference for special committees constituted of more than one member. This suggests that the Delaware judiciary may be eager to support a rule that either explicitly encourages this or even requires that special committees have multiple members.

#### A. *Gesoff v. IIC Industries Inc.*

A recent case from Delaware shows that a special committee will be subject to additional scrutiny when it contains only one member. In *Gesoff v. IIC Industries Inc.*, CP Holdings made a voluntary tender offer to take private its publicly traded subsidiary, IIC Industries.<sup>68</sup> In response, the subsidiary formed a special committee to make a recommendation to its shareholders on the tender offer. Critically, the committee had only one member.<sup>69</sup> The tender offer failed to put CP Holdings in a position to acquire the remaining shares by statutory short-form merger. Subsequently, CP Holdings completed the merger as a statutory long-form merger at the same price that the subsidiary's special committee recommended in the tender offer. The special director did not seek a new fairness opinion or undertake any new formalities on behalf of the minority shareholders after this change in transactional form.<sup>70</sup>

The Delaware Court of Chancery ruled in favor of the plaintiff shareholders after trial and awarded damages arising from the unfair price paid. The opinion by Vice Chancellor Stephen Lamb held the merger process was “marked with grave examples of unfairness, and led to a plainly unfair price for the going-private transaction.”<sup>71</sup> The court noted that the fact that

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<sup>68</sup> *Gesoff v. IIC Indus. Inc.*, 902 A.2d 1130, 1134 (Del. Ch. 2006).

<sup>69</sup> *See id.* at 1137-38.

<sup>70</sup> *See id.* at 1142-43.

<sup>71</sup> *Id.* at 1134.

the committee had only one member was a red flag because, “when a special committee is comprised of only one director, Delaware courts have required the sole member, ‘like Caesar’s wife, to be above reproach.’”<sup>72</sup> Further, the court made clear that Delaware courts “necessarily place[] more trust in a multiple-member committee than in a committee where a single member works free of the oversight provided by at least one colleague.”<sup>73</sup>

The court gave considerable attention to the issue of the one-member special committee, adding that the case illustrated why a special committee of one member is “such a worrisome portent of unfair dealing.”<sup>74</sup> The court noted:

Although the court acknowledges that no other independent director was available, and that Simon [the director who served] was independent of CP, this lone appointment necessarily causes the court to examine the entire process with a higher level of scrutiny, and equally causes the court to require more of Simon than it would had he been joined by other directors.<sup>75</sup>

An additional director “might have ameliorated the process by counseling Simon to think again, or by making it more difficult for CP to exert the control it exerted over the special committee. But that moderating influence was never available.”<sup>76</sup> The court also found that the special committee was uninformed of key information and of the conflicts of interests of its financial and legal advisers.<sup>77</sup> Indeed, the court’s comments call to mind the theorized reasons for superior group decision-making performance discussed above, such as error correction, the averaging function a group can provide, and groups’ ability to pool memories and skills, as well as to

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<sup>72</sup> *Id.* at 1146. In a footnote, the court explained the historical source of this aphorism was that it was Caesar’s response when asked why he divorced his wife after a false accusation of adultery. *See id.* at 1146 n.101. The court pointed out that “[s]ince Vice Chancellor Hartnett first cited Caesar’s famous aphorism in *Lewis v. Fuqua*, 502 A.2d 962, 967 (Del. Ch. 1985), in the context of a special litigation committee, it has been used repeatedly to describe the responsibilities of directors charged with managing committees of the sort at issue here.” *Id.*

<sup>73</sup> *Id.* at 1146.

<sup>74</sup> *See id.* at 1149. In fact in describing “a well constituted special committee,” the court noted that it should be “independent,” “given a clear mandate setting out its powers and responsibilities in negotiating the interested transaction” and “preferably, hav[e] more than one member.” *Id.* at 1146.

<sup>75</sup> *Id.* at 1149. The court did not elaborate more precisely on the “higher level of scrutiny” that it applied, or precisely what more it required of the sole director than it would have had he been joined by other directors.

<sup>76</sup> *Id.*

<sup>77</sup> *See id.* at 1166-67.

deliberate.

In sum, the *Gesoff* case shows judicial recognition of the need for boards to form special committees with multiple members and to give the committee a clear mandate and independent authority to handle the matter at hand. It also shows that courts will scrutinize a special committee's entire process more rigorously where the committee consists of only one member.

*B. In re Tele-Communications, Inc. Shareholders Litigation*

The Delaware Court of Chancery has also more subtly expressed its preference for multiple-member special committees. As in *Gesoff*, the Delaware Court of Chancery was critical of the special committee process in the case *In re Tele-Communications, Inc.* The court's unpublished memorandum decision intimated a preference for special committees containing more than one member.<sup>78</sup> The case arose from a merger in which Tele-Communications, Inc. ("TCI") merged with a subsidiary of AT&T.<sup>79</sup> TCI had a capital structure that included two classes of stock with different voting rights – Series A shares, providing one vote per share, and Series B shares, providing 10 votes per share. The merger provided a premium price for TCI's Series B shares. TCI formed a special committee of two directors during negotiation of the merger to "review any potential transaction," and decided that it would not recommend that TCI shareholders approve the transaction without the prior favorable recommendation of the special committee.<sup>80</sup> In addition, the board chairman recommended that the two special committee directors be "reasonably compensated" for their work on the transaction, but no specific compensation was determined.<sup>81</sup>

Subsequently, the committee met a few times to discuss the key deal terms, including a 10 percent premium for the Series B shares. The committee received advice from the counsel for TCI's investment banker regarding the committee's fiduciary duties in considering the premium, but did not retain independent counsel or financial advisers. TCI's investment banker presented a fairness opinion to the committee that concluded the transaction was fair to shareholders even though transactions in which high-voting stock received a premium to low-voting stock were "less common" than transactions in which all shares were compensated equally.<sup>82</sup> The fairness opinion did not, however, specifically assess the fairness of the transaction's proposed treatment of Series B shareholders vis-à-vis that of

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<sup>78</sup> See *In re Tele-Comm'ns, Inc. S'holders Litig.*, No. Civ.A. 16470, 2005 WL 3642727 (Del. Ch. Dec. 21, 2005).

<sup>79</sup> See *id.* at \*1.

<sup>80</sup> *Id.*

<sup>81</sup> See *id.*

<sup>82</sup> See *id.* at \*2.

Series A shareholders. Both members of the committee voted to approve the transaction. The same day, the board approved the transaction and it was subsequently carried out.

Series A shareholders sued TCI directors who had voted to approve the merger transaction, claiming they had breached their fiduciary duties. Because a majority of the TCI directors held Series B shares and received a premium, the court subjected the directors' actions to the "entire fairness" standard of judicial review instead of the more deferential business judgment rule.<sup>83</sup> The defendant directors thus had the burden of showing fair dealing and fair price.

In denying a motion for summary judgment and ordering the shareholder lawsuit to proceed to trial, the court observed multiple flaws in the special committee process. Although the court did not specifically take issue with the number of directors on the special committee, it did criticize the composition of the committee because it included a director who was not genuinely disinterested.<sup>84</sup> The director at issue held primarily Series B shares that would provide him with a premium of \$1.4 million. The other director on the committee held only Series A shares and the court did not take issue with his membership on the committee. The court questioned, however, why the committee did not include another director who stood to lose over \$13 million due to the premium paid for the Series B shares.<sup>85</sup> This comment conveys the court's preference for multiple-member special committees because the court did not simply suggest that the director with an interest in the transaction be removed from the committee, leaving only one member, but rather suggested that another director should have served in the interested director's place. Although admittedly a more subtle treatment of the issue than in *Gesoff*, the Delaware Chancery Court signaled a preference for a special committee of more than one member.

### C. *Perlegos v. Atmel Corp.*

Another Delaware case, *Perlegos v. Atmel Corporation*, provides a useful contrasting example to *Gesoff* and *In re Tele-Communications, Inc.* because it shows the court's less stringent treatment of a case involving a

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<sup>83</sup> See *id.* at \*6-8.

<sup>84</sup> The problem of a special committee containing directors who are not genuinely disinterested arises not infrequently. Perhaps most notably in recent times, the Delaware Court of Chancery held in *In re Oracle Corporation Derivative Litigation*, 824 A.2d 917 (Del. Ch. 2003), that the directors constituting a two-member special committee were not sufficiently independent to assess the merits of a derivative lawsuit on alleged insider trading by four members of the Oracle board because like the four directors at issue, the special committee members had strong ties to Stanford University.

<sup>85</sup> See *In re Tele-Comm's*, 2005 WL 3642727 at \*10.

special committee of multiple members.<sup>86</sup> In *Perlegos*, the Atmel board formed a special committee to investigate whether two founders, who were senior executives of the corporation, had improperly used corporate funds for personal travel expenses. The special committee consisted of five members. After conducting its investigation, the special committee unanimously voted to terminate the employment of the two executives. The fired executives then filed suit challenging their termination and the independence of the special committee members. Specifically, the executives claimed that the special committee's conduct was a pretext to cover the members' true motives, which included their own promotions, after the company terminated the executives.

The Delaware Court of Chancery rejected the executives' claims and held that they had failed to rebut the presumption of director disinterestedness and independence.<sup>87</sup> The court found that the special committee had a sufficiently broad mandate for its actions and had engaged in a reasonable process in determining to terminate the executives.<sup>88</sup> Unlike in *Gesoff* where the special committee consisted of only one member, here the board consisted of five members. The court made no mention of any additional scrutiny or any concerns about any structural weaknesses of the committee. This case demonstrates an acceptable special committee process and provides a useful contrasting example to the cases discussed above.

#### IV. APPLICATION OF THEORY SUPPORTING GROUP DECISION-MAKING TO SPECIAL COMMITTEES: RECOMMENDATIONS AND POTENTIAL CONCERNS

Better decisions by special committees will translate into more value for shareholders and less risk of litigation, which in turn could lead to savings in time, cost and reputation for the directors and the corporation. Group decision-making literature and recent case law underscores the potential for new rules or fine-tuning of the standards concerning the size of special committees.

##### A. *Recommendations*

The law, whether through statute or through the courts, should

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<sup>86</sup> See *Perlegos v. Atmel Corp.*, No. CIV.A. 2320-N, CIV.A. 2321-N, 2007 WL 475453, \*16-24 (Del. Ch. Feb. 8, 2007).

<sup>87</sup> See *id.* at \*20.

<sup>88</sup> See *id.* at \*20-24. Specifically, the court noted that the committee sought the advice of experienced and independent experts and adequately monitored them. In addition, the court found that the special committee reasonably relied on its counsel's advice to terminate the executives. The court also noted approvingly that the committee hired two law firms – one to do the investigation and a separate one to give an independent assessment of the firm's final report.



encourage boards to form special committees with more than one member. Courts should consistently apply higher levels of scrutiny to a special committee of only one member,<sup>89</sup> thereby encouraging counsel to advise their clients of this and to explain the underlying reason that motivates courts to scrutinize them more closely in the first place. Boards should know that decisions made by groups tend on average to be superior to those made by individuals and they should consider this when forming a special committee. Even when a board forms a special committee with more than one member, practitioners should closely analyze the independence of each director on the board, and the personal stake that each board member has in the potential transaction, when advising their clients in forming a special committee. Careful analysis in the formative stage of the committee may avoid judicial criticism of its composition later.<sup>90</sup>

Legislatures should encourage or even explicitly require that special committees be composed of multiple members. The studies, literature, and Delaware cases discussed above support this proposal by demonstrating that groups generally outperform individuals at decision-making. In a time when fiduciary duty law is criticized as serving only a weak monitoring mechanism for directors, courts and legislatures should place more emphasis on using the lessons from the social science literature and other disciplines to improve the structural mechanisms that foster good decision-making and, more broadly, corporate governance.<sup>91</sup> This proposal is in line with corporate law's tendency to focus on the board's decision-making process rather than the substantive decision that comes out of the process, while also aimed at strengthening the decision-making power of special committees.<sup>92</sup>

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<sup>89</sup> See *Gesoff v. IIC Indus. Inc.*, 902 A.2d 1130, 1146 (Del. Ch. 2006). ("The court necessarily places more trust in a multiple-member committee than in a committee where a single member works free of the oversight provided by at least one colleague. But in those rare circumstances when a special committee is comprised of only one director, Delaware courts have required the sole member, 'like Caesar's wife, to be above reproach.'").

<sup>90</sup> See, e.g., *In re Tele-Comm's*, 2005 WL 3642727 at \*10 (questioning the composition of the special committee and noting that the board should have considered including a board member who personally stood to lose from the proposed transaction as opposed to a board member who stood to gain from the proposed premium offered to a certain class of shareholders).

<sup>91</sup> Many scholars have argued for more robust fiduciary duty laws in light of recent corporate scandals. See, e.g., Cheryl L. Wade, *Corporate Governance Failures and the Managerial Duty of Care*, 76 ST. JOHN'S L. REV. 767, 768 (2002) ("Greater emphasis on standards of care for both directors and officers is warranted, especially in the aftermath of the corporate governance failures that scandalized Enron, WorldCom, and other large publicly held companies."); Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors' Fiduciary Duty Through Legal Liability*, 42 Hous. L. REV. 393, 407-08 (2005) (noting the erosion of legal liability for directors who breach their duty of care).

<sup>92</sup> Corporate law's business judgment rule is a clear example of this focus on process. See *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967-68 (Del. Ch. 1996) ("The business

Boards with sufficient independent directors could readily comply with this proposed rule. It would simply be a matter of using best practices in forming the special committee. The proposed rule should also apply, however, where a board does not have a sufficient number of pre-existing independent board members to form a special committee of two or more members. This was the situation of the board of directors in *Gesoff*.

When this situation arises, the board can take new outside directors, as boards commonly do when forming special litigation committees. This would of course come at a cost, but the additional cost would likely be justified because boards tend to form special committees when they must make important decisions and the threat of litigation lurks in the shadows. Depending on the situation at hand, it could also translate into more value for shareholders or at least instill more confidence from shareholders whose votes are needed for a transaction and who could pursue derivative litigation should they question the quality of the decision.

The additional expense of hiring an expansion director could also be worthwhile because the additional committee member may ease the burden on the director who would otherwise have to carry out the special committee process single-handedly.<sup>93</sup> The committee's responsibility may then be handled better overall. For example, as the Delaware Chancery Court noted in *Gesoff*, an additional director could help point out errors or areas that required further consideration.<sup>94</sup> In this same vein, it is widely understood that directors do not generally devote their full time to serving on the board and there may be a very real level of impracticality in assigning such a time-consuming and important task to a single director.<sup>95</sup> In addition, the improved

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judgment rule is process oriented"); see also Melvin Aron Eisenberg, *The Director's Duty of Care in Negotiated Dispositions*, 51 U. MIAMI L. REV. 579, 590 (1997) ("The sharp differentiation between the standards of review of the quality of board decisions on the one hand, and the decisionmaking process on the other, may be seen as a special case of recurrent legal tendency to review procedure much more intensively than substance.").

<sup>93</sup> Interestingly, research suggests that in some circumstances an individual will work harder in a group than when working alone. See Manstead, *supra* note 31, at 278 (citing K.D. Williams & S.J. Karau, *Social Loafing and Social Compensation: The Effects of Expectations of Co-Worker Performance*, 61 J. PERSONALITY & SOC. PSYCHOL. 570, 570-81 (1991)). A person who worked in a dyad with a less qualified partner on a task that required interdependent, additive work, worked harder than when working individually. See *id.* The effect of compensating for a partner's poor performance is called the "social compensation effect" or "social laboring" for the greater effort made on group tasks. See *id.*; see also Brown, *supra* note 31, at 183. The two key factors promoting greater effort on group tasks are the importance of the task and the significance of the group to its members. See Brown, *supra* note 31, at 183 (citing S.J. Karau & K.D. Williams, *Social loafing: a meta-analytic review and theoretical integration*, 65 J. PERSONALITY & SOC. PSYCHOL. 681-706 (1993)).

<sup>94</sup> See *Gesoff*, 902 A.2d at 1149.

<sup>95</sup> Consider as well that underlying the director's substantive decision about the actual matter at hand is a "meta-choice" or "second-order decision" about the strategy for reducing

procedure of having more than one member will instill more confidence in the quality of the decision from courts.

Although independent advisers or counsel often serve a critical function in assisting the special committee, such advisers are not a substitute for obtaining an additional special committee member if one is needed to form a multiple-member committee. Special committees often retain independent counsel, for example in the context of a management buyout or a parent-subsidiary merger, internal investigations, and special litigation committees evaluating shareholder derivative actions.<sup>96</sup> Such counsel do not have the same fiduciary duties as directors, however, and arguably do not have interests fully aligned with those of the special committee members and the corporation. Outside counsel of course have reputational concerns and certain duties to the client, but may be balancing other motivations as well, including fees and other clients' demands on their time. Further, counsel hired for a specific task may lack industry knowledge, familiarity with the company and relationships with the independent directors; proficiencies a new director would likely have or quickly develop. Moreover, the role of counsel is inherently advisory. The directors on the committee must ultimately oversee the work of the outside counsel and make the decisions at hand.

In sum, a rule requiring multiple members on special committees, or at least clearer standards from courts encouraging this practice, might require some boards to take new outside directors when forming a special committee. The additional cost would likely be justified, however, because of the myriad potential benefits that would flow from such a decision. This is important even where special committees have hired top-notch advisors and legal counsel.

One such benefit, apart from the advantages of group decision-making discussed above, is that the proposed rule might reduce structural bias that arises when directors evaluate their own colleague's conduct. Structural bias is specific to the special litigation committee (SLC) context.<sup>97</sup> It has been

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problems associated with making the decision. Depending on the situation, the various strategies the decision-maker chooses to use will vary in the extent they produce suboptimal decisions and the extent to which they impose burdens on the decision-maker. See Cass Sunstein & Edna Ullmann-Margalit, *Second-Order Decisions, Ethics* 110 (1999). A busy director tasked with being the sole member of a special committee could seek to reduce the information and options considered in order to reduce the personal cost of making the decision, which in turn could increase the chance of suboptimal outcomes. See *id.* at 9 ("It is largely because people . . . seek to reduce decisional burdens, and to minimize their own errors, that sometimes they would like not to have *options* and sometimes not to have *information*; and they may make second-order decisions to reduce either options or information (or both).").

<sup>96</sup> See Geoffrey C. Hazard, Jr. & Edward B. Rock, *A New Player In The Boardroom: The Emergence Of The Independent Directors' Counsel*, 59 BUS. LAW. 1389, 1390-92 (2004).

<sup>97</sup> For a brief discussion of special litigation committees, see *supra* Part I.

defined as “inherent prejudice against any derivative action resulting from the composition and character of the board of directors.”<sup>98</sup>

One scholar observed that a mitigating factor of structural bias is a board member’s ability to identify the “salient”<sup>99</sup> group boundary as not one between the board of directors and the shareholder-plaintiffs – but rather between the SLC and the rest of the board.<sup>100</sup> A board member’s “self-categorization” as part of the special committee would thus mitigate the collegiality of the committee members with the board as a whole and this frame of mind could be strengthened by formal structures emphasizing the distinctiveness of the committee as a group. For example, separate meetings from the full board, independent budget authority, and autonomy in seeking advice from counsel and other advisers could emphasize the distinctiveness of the special committee.<sup>101</sup> Accordingly:

SLC membership might serve as a viable counterweight to the collegial ties between SLC members and other directors. Many can recall examples of committees or task forces that have, for lack of a better word, “gelled,” and thus, exhibited a greater willingness to take on the larger group than would have been predicted given the dispositions of the individual members.<sup>102</sup>

This point, with its underpinnings in social psychology, intuitively makes sense. A one-member special committee cannot feasibly “gel” with himself,<sup>103</sup> and a single board member acting alone may have more difficulty establishing the formal structures separating the committee from the board that provide for independence and strengthen the member’s bond to the

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<sup>98</sup> Mark A. Underberg, Note, *The Business Judgment Rule in Derivative Suits Against Directors*, 65 CORNELL L. REV. 600, 601 n.14 (1980). In contrast, “[a]ctual bias results from the self-interested posture of a particular director in relation to a particular derivative claim.” *Id.* This student note was the first to apply the notion of structural bias to challenge the objectivity of special litigation committees and other commentators quickly began to use the term. See Davis, *supra* note 19, at 1307-08.

<sup>99</sup> “Salience” is a term used by social psychologists to refer to the question of “within a given context which, if any, applicable social categorization(s) will most significantly influence both self perception and impressions formed by others.” Penelope Oakes & John C. Turner, *Distinctiveness and the Salience of Social Category Memberships: Is There an Automatic Perceptual Bias Towards Novelty?*, 16 EUR. J. SOC. PSYCHOL. 325, 325 (1986).

<sup>100</sup> See Davis, *supra* note 19, at 1323; see also Robert B. Ahdieh, *The Role of Groups in Norm Transformation: A Dramatic Sketch, In Three Parts*, 6 CHI. J. INT’L L. 231, 253-255 (2005).

<sup>101</sup> See Davis, *supra* note 19, at 1323-34.

<sup>102</sup> See *id.* at 1323.

<sup>103</sup> See, e.g., Manstead, *supra* note 31, at 262 (noting that cohesiveness is one of the most basic properties of a group, and that “it makes sense to say that a group is cohesive, but not that an individual is cohesive”).

committee.<sup>104</sup> Likewise, the appointment of new board members to increase the committee size would also likely promote the committee's independence.<sup>105</sup>

Finally, in addition to the proposal above, this Article calls for more targeted primary research on group decision-making in the special committee context. As noted, the decision-making tasks and group processes that researchers have studied to date are analogous to decision-making in various contexts, including special committees. The long history of study results showing better decision-making performance by groups than individuals should also be recognized. Nonetheless, it is natural that critics may be skeptical of whether experimental data gathered from a laboratory setting offers insight or explanatory power in the real world.<sup>106</sup> Targeted empirical work for special committee design would help answer any such potential concerns and bolster efforts to provide reliable prescriptions for improving special committee decision-making.<sup>107</sup> Such research could also provide further insights on issues such as mitigating group cognitive biases that might arise in special committees.

This research may be difficult to execute because studying the complex decisions special committees make is not easily done in a laboratory setting and real-world outcomes may not be easily evaluated or ranked against results that did not materialize or results from a different factual scenario. Conducting research with interactive groups is time consuming, costly, and the resulting data may be hard to understand or explain.<sup>108</sup> Likewise, analyzing anecdotal evidence may be of limited utility because it may not give a full picture and critical evaluation of decision quality would be difficult.

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<sup>104</sup> See Brown, *supra* note 31, at 189-90 (discussing studies showing the importance of social identity for performance).

<sup>105</sup> See Davis, *supra* note 19, at 1324 ("For these new appointees, most of their sense of themselves as board members will be tied up in their common experience serving on the SLC."). Dean Davis also points out, however, that the consequence of appointing new outside directors, often called "expansion directors," is that it opens the door to selection bias. He notes that "the case law to date has not directly confronted this tension between collegiality and selection bias as such." He argues that expansion directors "should be treated as no more independent than the incumbents who appointed them," and proposes that courts should place less emphasis on the independence of the SLC members and more emphasis on the merits of their substantive decision. See *id.* at 1359-60.

<sup>106</sup> See Bainbridge, *supra* note 2, at 14-15; see also Seidenfeld, *supra* note 3, at 490.

<sup>107</sup> See William N. Eskridge, Jr. & John Ferejohn, *Structural Lawmaking to Reduce Cognitive Bias: A Critical View*, 87 CORNELL L. REV. 616 (2002) (recognizing cognitive psychology as a useful critical theory to supplement our understanding of various institutional interactions and processes of policy debate and deliberation, but expressing skepticism about attempts to use cognitive psychology to support a specific institutional design or role without an adequate empirical basis).

<sup>108</sup> See Manstead, *supra* note 31, at 270 (discussing the difficulties of research into group processes).

Nevertheless, this is an area that merits further laboratory or empirical research, even with its limitations, for the reasons listed above, and more fundamentally, because of the importance of special committees and boards within corporations, the pillars of our economy.

The study of group decision-making and negotiation is becoming a recognizable field of study in its own right and could also be an avenue for new research applicable in the special committee context. Its roots are incredibly multidisciplinary, with researchers from organizational behavior, psychology, operations research, and other disciplines.<sup>109</sup> Scholars in the field have noted that in developing analytical methods and support tools, social and behavioral theories must be considered more consistently and deeply.<sup>110</sup> This shows a commitment in the field to considering multiple perspectives, including organization theory, cultural aspects, small group theory, political science and management theory, which will deepen the level of research and analysis in the area. Research on methods and models of group decision and negotiations processes could provide useful data to apply to special committees.<sup>111</sup>

### B. *Potential Concerns and Responses*

Criticism of a law requiring that special committees consist of more than one member is likely to center around the cognitive biases that can affect group decision-making. Further, the proposal could be interpreted as contrary to the recent trend of small corporate boards. The proposal set forth in this Article withstands these potential concerns.

#### 1. Cognitive Biases

As to the first potential concern, cognitive biases do not appear to push conclusively for or against the use of groups to make decisions. Some background on cognitive biases is first necessary to explore this response.

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<sup>109</sup> See Susan E. Brodt, *Innovative Approaches to Research on Group Decision and Negotiation*, GROUP DECISION AND NEGOTIATION 6:283-287 (1997).

<sup>110</sup> See Gregory E. Kersten, *Support for Group Decisions and Negotiations*, [http://www.iiasa.ac.at/Research/DAS/interneg/research/misc/intro\\_gdn.html](http://www.iiasa.ac.at/Research/DAS/interneg/research/misc/intro_gdn.html). This overview notes that research on group decisions and negotiation is usually published in general journals in the fields of management sciences, operations research and information systems, often with dedicated special issues (for example, *Annals of Operations Research, Control and Cybernetics, Decision Support Systems, EJOR, Management Sciences, Theory and Decisions*), area-specific journals such as *Group Decision and Negotiation* and *Negotiation Journal*, and edited books. Other sources include research on negotiation modeling and negotiation support systems (often referred to as “NSS”), multi-criteria decision-making (“MCDM”) approaches to group support, and group decision support systems (“GDSS”).

<sup>111</sup> For a sampling of work from leading researchers in the various areas making up this field of study, see Fisher and Ury, 1983; Zartman, 1994; Kremenuk, 1991; Pruitt, 1991; Lax and Sebenius, 1986.

Psychology scholars have observed that when individuals make decisions they often do not act in the rational, optimizing fashion that economists assume or have previously assumed. Instead, individuals are susceptible to making cognitive errors that result in predictable biases. Individuals tend to use decision-making shortcuts or simplifications without evaluating whether they are maximizing the net benefits of their decision. These shortcuts and simplifications allow the decision-maker to rely on his or her experience or expertise to predictably resolve the issue rather than devote resources to fully and optimally consider the decision in light of all of the relevant information.<sup>112</sup> In addition to finding that individuals do not always act in a perfectly rational and optimizing fashion, psychology scholars have also theorized and studied many patterns of deviations in judgment that have come to be generally known as cognitive biases.

Cognitive biases specific to group interaction may negatively affect group decision-making. These biases include group polarization, group confirmation bias, inadequate reporting and use of shared information, and groupthink.<sup>113</sup> Because these group cognitive biases could affect multiple-member special committees, they also merit a brief explanation.

Group polarization refers to people's tendency to make more extreme judgments or to prefer more conservative or riskier courses of action when they are in a group rather than when making the decisions alone.<sup>114</sup> Researchers believe this leads to greater variability in group decisions.<sup>115</sup> Group confirmation bias refers to a group's tendency to seek new information or interpret new information in a way that supports or confirms previously

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<sup>112</sup> See Seidenfeld, *supra* note 3, at 491-94 & nn.22-23 (2002) (describing the decision-making shortcuts or simplifications that decision-makers use as a "decisionmaking rule," meaning "the use of predetermined categories into which a person places factual circumstances to derive an outcome."); see also SCOTT PLOUS, *THE PSYCHOLOGY OF JUDGMENT AND DECISION MAKING* 107-88 (McGraw Hill 1993); HEURISTICS AND BIASES: *THE PSYCHOLOGY OF INTUITIVE JUDGMENT* (Thomas Gilovich et al. eds., Cambridge Univ. Press 2002); *JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES* (Daniel Kahneman et al. eds., Cambridge Univ. Press 1982).

<sup>113</sup> These concepts come from cognitive psychology research and theory. Professor Seidenfeld's work, cited above, discussed these concepts in the context of his thesis that "the psychology of individual decisionmaking biases and group decisionmaking dynamics suggests that judicial review does improve the overall quality of rules." See Seidenfeld, *supra* note 3, at 489. Other scholars have discussed these concepts in a range of contexts. See, e.g., Eskridge & Ferejohn, *supra* note 107, at 623, n.24. (raising the issue of group cognitive limitations in the context of groups of public-regarding public servants).

<sup>114</sup> See Moscovici, S., & Zavalloni, M., *The Group As A Polarizer of Attitudes*, J. OF PERSONALITY & SOC. PSYCHOL. 12, 125-135 (1969); see also Seidenfeld, *supra* note 3, at 535. This phenomenon was called "risky shift," but as research showed that the group tendency towards extremes can be toward risk or caution, the more precise term "group polarization" took hold. See Manstead, *supra* note 31, at 266.

<sup>115</sup> See Seidenfeld, *supra* note 3, at 536 & n.269.

held beliefs and to avoid information or interpretations that would contradict those beliefs.<sup>116</sup> Groups also tend to consider shared information more than unshared information, and unshared information tends to be inadequately reported and underutilized. Finally, groupthink is “[a] mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members’ strivings for unanimity override their motivation to realistically appraise alternative courses of action.”<sup>117</sup> Clearly, if actualized, these cognitive biases have the potential to work against groups seeking to make optimal decisions. The important question is thus how serious of a concern they actually present.

Unfortunately, the effect of cognitive biases is inconclusive because researchers have not quantified the effect of group cognitive biases generally, much less in the particular context of special committees.<sup>118</sup> Indeed, determining the exact effect of group cognitive biases in various circumstances may be an unattainable goal given the nature of the subject. Further, researchers have not established as a general matter that groups tend to suffer more (or less) than individuals from the effects of cognitive biases in decision-making.<sup>119</sup> Thus the research on cognitive biases does not

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<sup>116</sup> See Dieter Frey, *Recent Research on Selective Exposure to Information*, in 19 ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY 41 (Leonard Berkowitz ed., 1986); see also Seidenfeld, *supra* note 3, at 535, 538-9.

<sup>117</sup> JANIS, IRVING L., VICTIMS OF GROUPTHINK 9 (Houghton Mifflin Co. 1972).

<sup>118</sup> Concern about polarization, at least, seems somewhat overstated in the literature. Almost all studies on which conclusions about polarization have been made were conducted in laboratory settings with ad hoc groups in which the outcome was hypothetical. See Brown, *supra* note 31, at 199-200. Researchers rarely gain access to real decision-making groups for observational field study, but studies under such real circumstances have generally not shown polarization. See *id.* (citing G. Semin & A.I. Glendon, *Polarization and the established group*, 42 BRIT. J. SOC. & CLINICAL PSYCHOL. 281-91 (1971)). Cutting against this is a study of federal judges’ decisions that showed that a significantly greater percentage of cases heard by a panel of three judges, as opposed to a single judge, could be classified as libertarian. See *id.* (citing T.G. Walker & E.C. Main, *Choice shifts in political decision making: federal judges and civil liberties cases*, 3 J. SOC. PSYCHOL. 39-48 (1973)). One persuasive explanation is that unlike ad hoc laboratory groups, real decision-making groups usually have qualities that might inhibit polarization such as a longer term existence, an internal structure such as designated officers, conventional procedures such as written agendas, and established norms about the subject matter. See *id.* Judicial panels that convene for just one case or a cluster of cases are more analogous to the ad hoc laboratory groups in that they usually come together just for that discrete task and then disband. See *id.* Special committees, depending on their mandate and the circumstances, may fall somewhere in between on this spectrum.

<sup>119</sup> See Max Minzner, *Detecting Lies Using Demeanor, Bias, and Context*, 29 CARDOZO L. REV. 2557, n.103 (2008) (citing N. Kerr et al., *Bias in Judgment: Comparing Individuals and Groups*, 103 PSYCHOL. REV. 657, 713 (1996), for the proposition that “there is no simple empirical answer to whether groups or individuals are likely to make biased judgments.”). For information on individual biases, see JOHNATHAN BARON, THINKING AND DECIDING (Cambridge Univ. Press 3d. ed. 2000); THOMAS GILOVICH, HOW WE KNOW WHAT ISN’T SO:



conclusively weigh in favor or against the use of groups to make decisions.

Perhaps the most that can be said on the topic without further critical study is that members of groups should become aware of the cognitive biases they may be susceptible to and take steps to mitigate these biases. Professor Cass Sunstein has provided the following advice:

[S]tructure deliberation so as to increase the likelihood that relevant information will emerge. A norm in favor of critical thinking, and incentives to reward individuals for good decisions by groups, can overcome some of the relevant pressures. Leaders should take steps to encourage a wide range of views; to do this, leaders might be cautious about expressing their own views at the outset and should encourage reasons, rather than conclusions, before the views of group members start to harden.<sup>120</sup>

Similarly, social psychology literature supports a facilitative leadership style that maximizes effective participation of all group members to draw out relevant ideas, information, alternative viewpoints and criticism.<sup>121</sup> Research has shown that groups can improve their outcomes by taking time at the start of their discussion to plan how they will proceed. They should also reflect on common group decision-making perils, such as inadequate information sharing, groupthink, etc.<sup>122</sup> Those who wish to minimize exposure to group cognitive biases could further explore the extensive literature on this topic for additional insights.<sup>123</sup>

## 2. Trend Toward Smaller Board Size

Another potential concern with respect to requiring special committees to consist of more than one member is that this idea may run counter to recent literature proposing smaller board size. The recommendation, however, does

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THE FALLIBILITY OF HUMAN REASON IN EVERYDAY LIFE (The Free Press 1993); HEURISTICS AND BIASES: THE PSYCHOLOGY OF INTUITIVE JUDGMENT (Thomas Gilovich et al. eds., Cambridge Univ. Press 2002); JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES (Daniel Kahneman et al. eds., Cambridge Univ. Press 1982).

<sup>120</sup> Cass R. Sunstein, *Group Judgments: Statistical Means, Deliberation, and Information Markets*, 80 N.Y.U. L. REV. 962, 1048 (2005).

<sup>121</sup> See Brown, *supra* note 31, at 217-21.

<sup>122</sup> See *id.*

<sup>123</sup> See, e.g., Turner, M.E. & Pratkanis, A.R., *Mitigating Groupthink by Stimulating Constructive Conflict*, in Carsten K.W. De Dreu & Evert Van de Vliet (Eds.), USING CONFLICT IN ORGANIZATIONS 53-71 (Sage Publications Ltd. 1997); see also Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CINN. L. REV. 1233, 1243 (2003).

not conflict with the views expressed in that literature. The explanation is quite straightforward.

The recent literature championing smaller boards addresses the collective action problem that boards of directors face in carrying out their duties.<sup>124</sup> Some commentators link the collective action problem to the size of boards and have suggested that firms should reduce their board size.<sup>125</sup> The underlying notion for this recommendation is the theory that board size negatively correlates with firm performance because the larger the board, the less an individual director perceives he will take the blame for poor performance and so will monitor the executives less.<sup>126</sup> In addition, scholars have noted that coordination becomes more difficult with larger boards and thus costs are increased.<sup>127</sup>

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<sup>124</sup> See, e.g., Kay Xixi Ng, *Inside the Boardroom: A Proposal to Delaware's Good Faith Jurisprudence to Improve Board Passivity*, 6 DEPAUL BUS. & COM. L.J. 393, 402-05 (2008). The collective action problem translates into passive boards that do not truly serve the monitoring function over the executives that they are theorized to serve. See, e.g., Charles M. Elson & Christopher J. Gyves, *The Enron Failure and Corporate Governance Reform*, 38 WAKE FOREST L. REV. 855, 857 (2003) ("Yet, despite this legal expectation for active monitoring, the reality is that boards of directors in many instances have become reasonably unimportant and impotent entities—mere 'parsley on the corporate fish.'"); see also Bainbridge *supra* note 2, at 8-9 (discussing trends in literature encouraging more active board oversight). According to these commentators, the ratio of what a director perceives to get from his monitoring efforts is often slight in contrast to his perceived cost for doing it – the director may improve his reputation or benefit from an increase in stock price when monitoring improves the firm's performance, but the cost of his time and the potential social disruption of such monitoring could be significant. Further, even though directors are officially elected by the shareholders, directors may believe that they owe their jobs to the executives because it is common for executives to choose the board candidates and the shareholders simply ratify the selection. See Ng, *supra*, at 394; see also Benjamin E. Hermalin & Michael S. Weisbach, *Endogenously Chosen Boards of Directors and Their Monitoring of the CEO*, 88 AM. ECON. REV. 96, 96 (1998). Directors may not want to appear aggressive or untrusting of the executives because of worry that it could cost them their board position and their chances for obtaining other board positions. In addition, directors may not perceive any problems with the management without doing further investigation. The incentive structure for directors doing this investigation is generally inadequate because directors only work part time in their positions and usually do not get paid for additional time spent outside of meetings and special committee participation. See *id.* at 403; see also Martin Lipton & Jay W. Lorsch, *A Modest Proposal for Improved Corporate Governance*, 48 BUS. LAW. 59, 64 (1992).

<sup>125</sup> See Ng, *supra* note 124, at 402; see also Sanjai Bhagat & Bernard S. Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. LAW. 921, 941-42 (1999); Lipton & Lorsch, *supra* note 124, at 65; Theodore Eisenberg, Stefan Sundgren, & Martin T. Wells, *Larger Board Size and Decreasing Firm Value in Small Firms*, 48 J. FIN. ECON. 35 (1998).

<sup>126</sup> See Ng, *supra* note 124, at 402.

<sup>127</sup> See Lipton & Lorsch, *supra* note 124, at 65; Bainbridge, *supra* note 2, at 6-7 (discussing how hierarchy constrains agency costs within the firm).

This Article's proposal to require special committees to contain more than one member is not inconsistent with the position of scholars who have lamented board passivity and those who have recommended that firms reduce their board size. This is because although group decision-making theory suggests that groups generally make better decisions than individuals do, the focus of this work has not been on any particular group size. There is nothing to suggest that a firm cannot minimize the collective action problem by avoiding a large board while still forming special committees that contain more than one member.<sup>128</sup> Moreover, boards generally form special committees for a specific purpose, such as in response to shareholder litigation or for a strategic transaction. The theorized board passivity and coordination problems may be much less of an issue for special committees, if at all, because of their narrower purpose and smaller size than a full board, even with multiple members.

## V. CONCLUSION

Special committees make some of the most important decisions facing corporations; decision-making is central to special committees' purpose. Sometimes a board will create a special committee of just one person to handle a crucial matter. Research shows, however, that groups tend to make better decisions than individuals do. Negotiation theory further bolsters a preference for group decision-making. Recently, Delaware courts have noted some of the empirical and scholarly work on group decision-making and have recognized the advantages of having multiple members on special committees.

This Article proposes that courts or legislatures firmly establish a preference or requirement that special committees consist of more than one member. This will improve the structural mechanisms that foster good decision-making in special committees and, more broadly, better corporate governance. Even in the absence of a formal change in corporate law on this matter, boards as a practical matter should only form special committees with multiple members. Lawyers should counsel their clients of the same. This is the best practice in light of the research and negotiation theory suggesting this will improve committees' decisions, as well as Delaware courts' preference for this practice. Finally, this Article also calls for more targeted primary research on group decision-making in the special committee context.

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<sup>128</sup> No significant experimental research has been done on whether there is an optimal board size. See Bainbridge, *supra* note 2, at 42.